RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED
SINCE 1958 •
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26 LETTERS PER YEAR • $225 ANNUALLY

May 16, 1990 LETTER 1043

May 4 DJIA 2710.36; PTI 3232; A-D Ratio -11.35
May 11 DJIA 2801.58; PTI 3252; A-D Ratio -10.47
Dow Yield: 3.60%; Dow P/E: 12.5; DowPow: 347
Dow Book Value: 1075; Dow 200-day MA: 2693
Percentage of Undervalued Blue-chips: 23%
PTI 89-day Moving Average: 3263

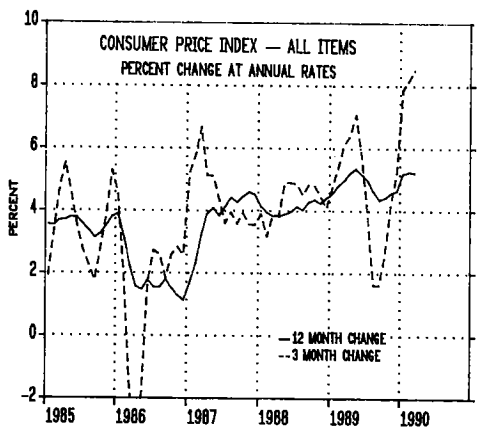
THE MARKET: This market has had every chance to fall apart, but it has preferred to split. The split is obvious -- the majority of stocks as measured by the advance-decline lines on all the exchanges lag or actually decline while the Dow and many of the blue chip issues resist mightily, with many blue chip stocks rallying. The Dow just doesn't seem to want to fall apart, and if the Dow won't go down, then sooner or later it will move the rest of the market up.

Let me put it another way -- this market "feels" as if it wants to look good before it looks bad (by the way, that's an old bear market tactic). So how can this schizophrenic stalemate be resolved? One way would be for a rally to take the Dow to a new high above 2810.15. The breadth and the Transports would obviously not confirm, and then the trouble could begin.

Or -- the market could cave in from here and produce a really impressive, over-sold low. From such an area a powerful advance could materialize, one that I would be tempted to play. From the look of things at this writing, however, the first scenario is what's happening.

THE PICTURE: The big picture is this: inflation, chronic inflation, is built into the US economy (and probably into the global economy). Our government tells us that inflation is running at a 4.5% to 5.5% rate, but you and I know better. Next year Yale University will raise its tuition 7.8%. Selected air fares are going up 10%. The price of food at the supermarkets seems to go up almost weekly. Movie tickets are up to the $6.50 to $7.50 level. Cab, bus and subway fares are rising. The real inflation rate, the rate you and I have to live with, are probably going up at around a 10% rate. By the way, at 5% inflation the purchasing power of the dollar is halved in less than 20 years.

This chart (courtesy of Smith Barney) tells the story quite well. Here you see (dotted line) that the Consumer Price Index is rising at a 5.5% on a 12- month change basis, but on a three month change basis the inflation rate has accelerated to 8.5%.



The Fed worries about inflation, but that seems to be about as far as it goes. Of course, the Fed is constantly pressured by Mr. Bush and assorted Congressman to bring rates down. There's only one way to end inflation, and that's with a recession (Paul Volcker knew that). But the Fed and Mr. Greenspan are afraid to apply the real medicine. They are afraid of the wrath of the politicians, and they are deathly afraid of setting off a recession. The Fed knows, with the sky-high levels of debt in the US, that a recession could quickly turn into a depressionary collapse.

So the sham goes on, the federal debt continues to rise (at the rate of over $5 billion a week), interest rates remain high, and chronic inflation reigns.

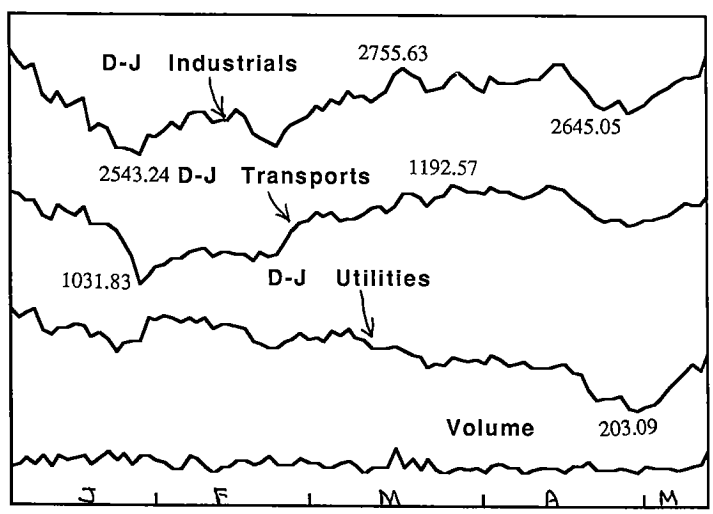
Nevertheless, the long-term bond market is a free market. There, we're seeing Treasury bonds going at yields of around 9%. Mortgage rates have pushed well over 10%. And US banks, frightened by an ocean of "problem loans," have pulled in their horns and become much more selective about making loans.

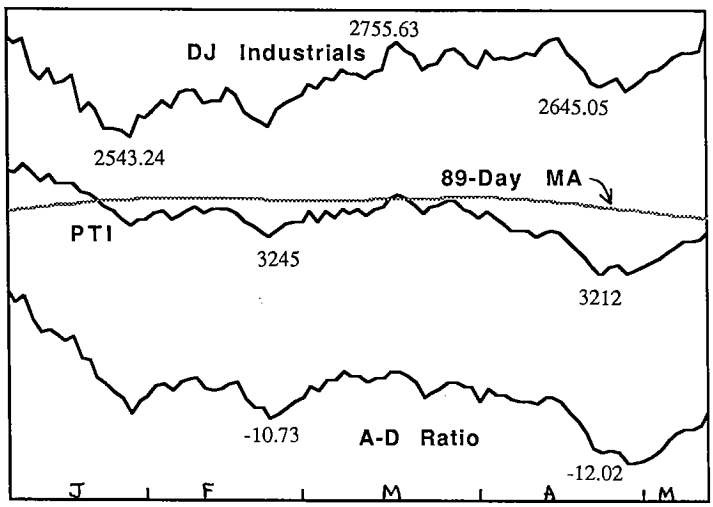
The result is something approximating a credit crunch. But it's not a full-fledge credit crunch, yet.

Global Picture: *Fuller Money,* the brilliant international investment letter (7 Swallow St., London, WIR 7HD) begins its latest report as follows: "Excessive debt, high interest rates, declining bonds and stocks, a slowing of asset appreciation, waning growth but rising inflationary pressures, are consuming wealth. Japan and Germany are repatriating capital, squeezing the deficit countries. The global stock market bear gathers pace. Only seven of twenty six (international) stock markets show gains this year. Eighteen stock markets moved to post-peak reaction lows in April."

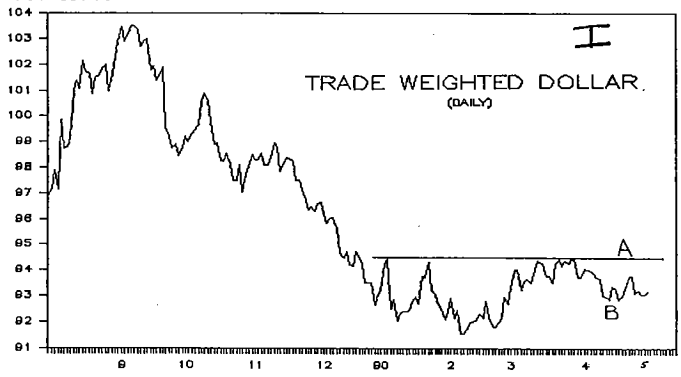
CHARTS: Every once in a while I like to tell the market/economic story in charts. On the thesis that one chart is worth a thousand inane sentences, here we go.

The first chart (p.2, Chart I) may be the most important one around. It's a chart of the trade weighted dollar. To put it bluntly, this is one rotten looking chart, and it will remain that way unless the dollar can rally above horizontal trendline A. On the other hand, if the dollar falls below point B, it's going to look ominous.



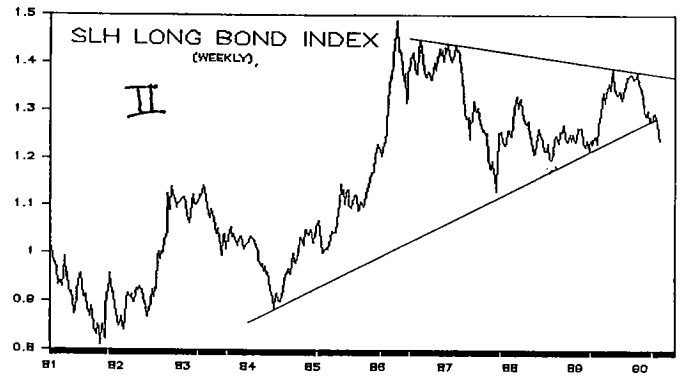


The problems facing the dollar have been discussed here ad nauseam, but a short listing includes the trade deficit, the budget deficit, inflation, declining productivity and a possible US recession. Finally, a weak dollar makes US bonds less attractive to foreigners. And we depend on foreigners to buy our never-ending debt issues.

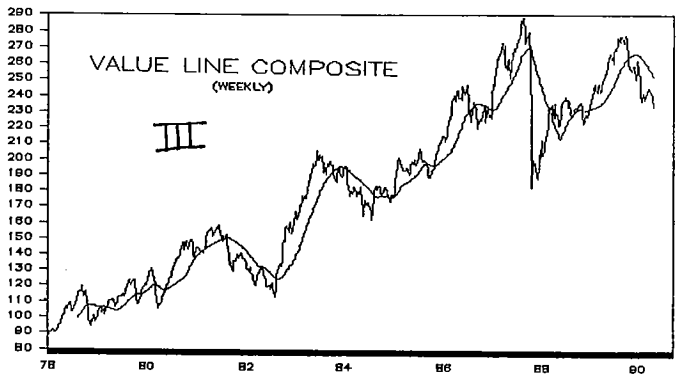


The chart at the top of the right-hand column shows **Shearson's Long Bond Index**. This chart has just turned bearish, the price action having fallen out of a massive 1986-90 triangle. This is not a happy picture. For as you know, the US's debt markets dwarf its equity markets, although bond yields always compete with stock yields.

The next chart is the **Value Line Composite**, and as I've said many times before the VL Composite is a fair proxy for the value of the average stock portfolio. Note that the VLC failed to make a new high (above the 1987 high) in January 1990 (although at the time the Dow did record a new all-time high). After that failure, the VLC turned down and broke below its moving average. As of this



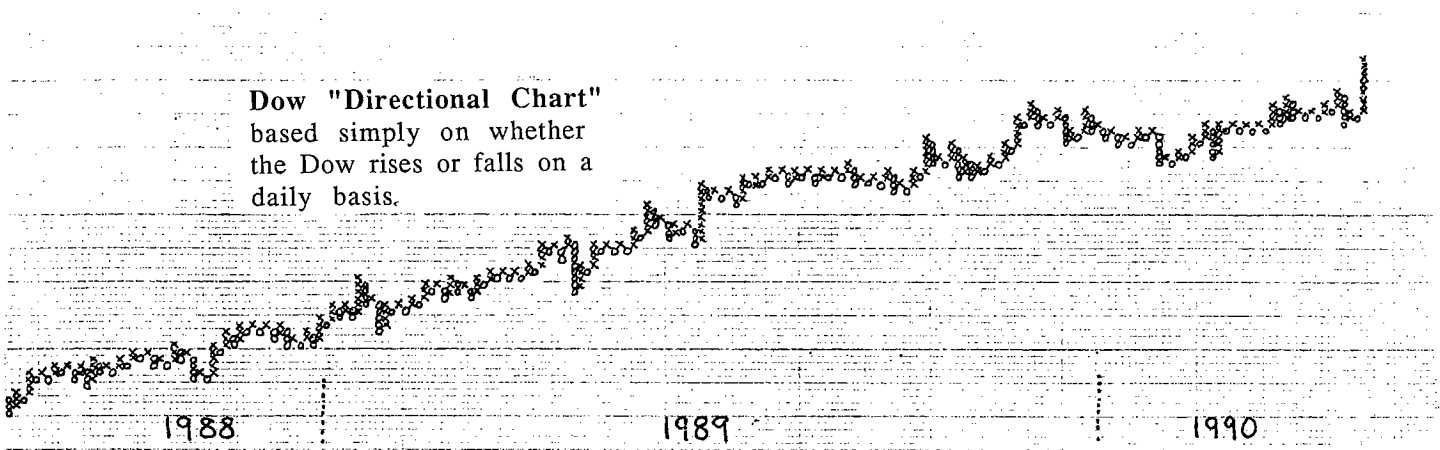
writing, the VLC is most definitely bearish. (These three charts are courtesy of Paul Eldridge and the Ruff Organization).



The chart at the bottom of this page is a Russell original, and it's one that I guess you could call "the hope of the bulls" (although it's a chart that not one out of a thousand bulls has ever seen). This is a simple point & figure **"directional chart" of the Dow**. On any day when the Dow advances, the chart gets an upside X. On any day when the Dow declines, the chart gets a downside O. So what this chart shows is the direction of the Dow based strictly on up or down days (remember, only direction is shown, not extent of move).

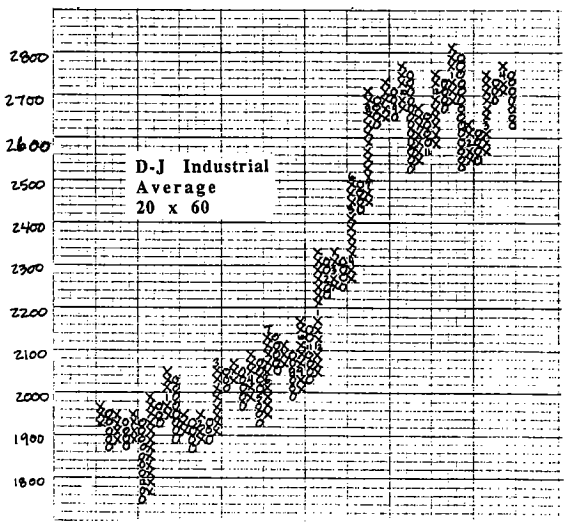
The chart starts in September 1988 and runs to the present. As you can see the chart portrays a definite rising trend. Last week this indicator rose to a new high.

If we are in a true primary bear market this directional indicator must turn down. So far, and there's no question about it, the Dow has mightily resisted the downward forces of the rest of the market (i.e., the rest of the market as gauged by the advance-decline ratio). Continued resistance to decline on the part of the Dow has set off periodic sharp market advances, but each time when this occurred breadth was poor. Expect more of the same until the top is finally completed.



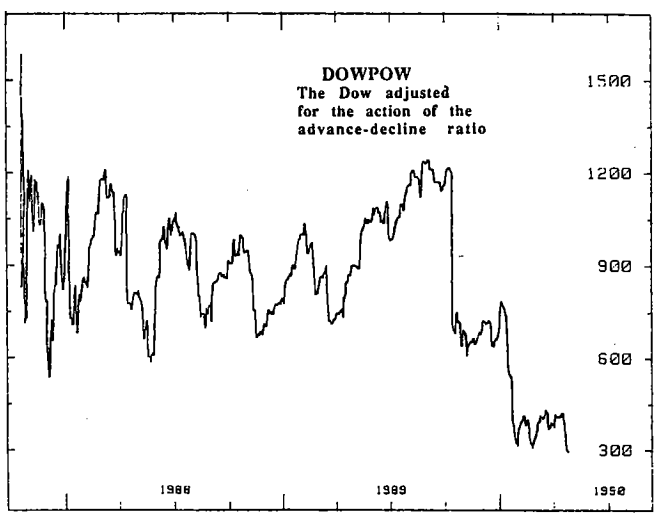
Let me put it this way -- when the bear really takes over, the Dow and everything else will head down. I know there has been a lot of money lost in this market since late-1989, but if this is to be a true bear market my Dow directional index will also have to establish a downtrend, the very opposite of what we just haven't seen on this chart.

This chart is a 20 x 60 point & figure chart of the **Dow.** Translated, this means that each box on the chart is equal to 20 points and only rallies and declines of 60 points or more are shown. In other words, this is a very concentrated picture of the Dow. On this chart it looks as if the Dow is forming a huge potential top, but I want to emphasize the word potential. The Dow would have to sink to the 2520 box before this top formation breaks down.



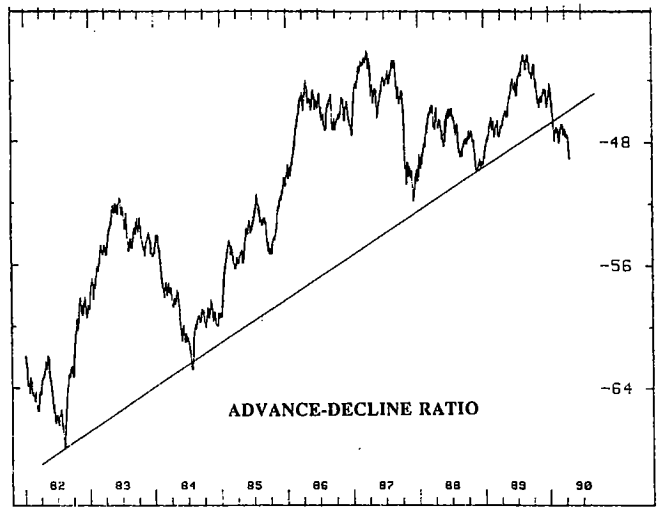
Just to add to the confusion, here is a chart of **DowPow,** my proprietary index of the Dow adjusted for the daily action of the advance-decline line. Since the third quarter of 1989 DowPow has been in a state of collapse with a new low recorded on DowPow just last week. I've worked with DowPow for a number of years, and I can tell you that it's extremely difficult to make money in the market when DowPow is in a downtrend and hitting new lows.

DowPow was moving erratically sideways during 1988 and the first half of 1989, and that told me that if you were lucky and picked the strongest stocks you could have made money during that period. But starting in the third quarter of 1989 DowPow hit the skids. With that kind of action on the part of DowPow, being in the market is a loser (this chart of DowPow and the following chart of the advance-decline ratio are courtesy of John Carder, *Topline Investment Graphics*, PO Box 4283, Boulder CO 80306).

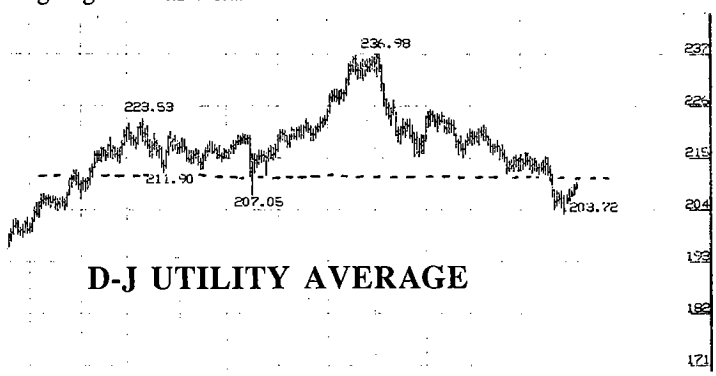


Marty Zweig, in his latest report, writes a good deal about the Dow/breadth divergence. Marty notes that from this year's January low the Dow gained 8.8% while the Zweig Unweighted Price Index "gained a meager 2.2%. Moreover," he continues, "the breadth figures were about as limp as on any comparable rally since the summer upswing of 1929. As if that wasn't bad enough, average daily volume dropped about 15% as the blue chips rallied. This completed a rather rare volume divergence last seen a few weeks before last year's October 13 mini-crash and in the summer of 1987 before the Big Crash."

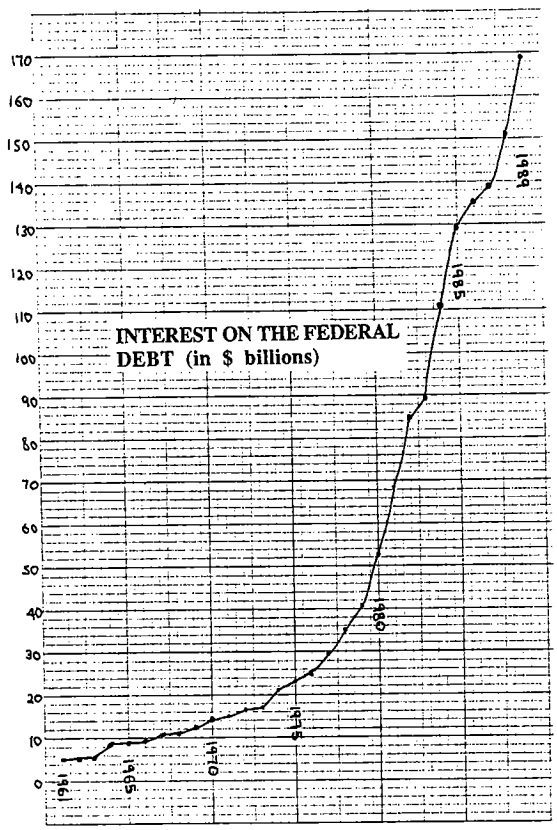
Next, I'm including a long-term chart of the **advance-decline ratio.** The A-D ratio traces the advancing or declining action of the majority of stocks on the NYSE. As you can see, the A-D ratio held to a definite rising trend from 1982 until the third quarter of 1989. Even the 1987 crash failed to break the advancing trend. But in late-1989 the trend of the A-D ratio turned decisively down. It will be extremely important to see if this downtrend continues and whether future A-D action takes place below the old rising trendline (this is another *Topline* chart).



This is a chart of the **D-J Utility Average,** and it's bearish (chart courtesy of *Mansfield*). This chart is particularly important because the Utility Average has a history of often moving in direction well before the rest of the market. In the past, I have noted that whenever the D-J Utility Average and bonds move up or down together, the stock market will follow. Of late, both the Utilities and bonds have been going down, and most of the market has been going down as well.



Here's a chart that I publish at least once a year. It's a chart that your Congressman and the Administration don't want you to see. This is the **annual interest on the federal debt** (no this isn't the debt, it's just the interest on the debt). From $6.7 billion in 1961, the interest cost climbed to $14.4 billion in 1970, then to $52.5 billion in 1980, to $129.4 billion in 1985 and to $169 billion in 1989. With short rates over 8% and the deficits climbing dramatically, my guess is that the interest on the federal debt will push near or above $190 billion this year.



Jim Grant (of *Grant's Interest Rate Observer*, 233 B'way, NYC 19279), notes that in 1961 the interest rate expense was 14 times tax receipts. In 1980 interest on the debt was 9.8 times receipts. Last year in 1989 it was 5.9 times receipts. Obviously, this trend cannot continue. For if it does, the interest on the federal debt will start approximating the government's total tax take!

Can the Treasury continue to pay the interest on its growing mountain of debt? Sure they can. But the question is, what will they pay it with?

In his latest mailing, Jim Grant writes, "Among the world's great debtors, the US Government is uniquely blessed. It can borrow extensively, even from foreigners, in a currency that it has not been pressed to define. A dollar is just what the Government say it is. Here is a monumental conflict of interest. To be able to print one's way out of debt is another recurring fantasy, but other debtors don't own the Bureau of Engraving and Printing or control the policy of the Fed. As the cost of the public debt continues to rise, the Government must face the temptation to pay with debased currency." Russell comment: And that's a temptation our government has never been able to resist!

Reagan let the deficit roar, and Bush has done the same -- up to now. But the S&L fiasco, lower tax receipts and the power of compounding (compounding the debt, that is) has knocked Bush's optimistic (and totally unrealistic) budget projections into a cocked hat. So Bush is forced to at least "talk" to Congress about lowering the deficits. Expect more compromises and half-measures and the usual "we're OK" rhetoric.

INVESTMENT POSITION: The bear remains in the box, and I have to confess that I can't think of anything brilliant to do here -- unless you consider sitting with T-bills and watching the tape on TV as brilliant.

Quiet and confusing markets generally give way to clear and exciting markets, so be patient.

NOTES & QUOTES: The threat of a credit crunch remains. Up to now West Germany and Japan have been the two major suppliers of world liquidity. But West Germany's new Deutsche marks will now be going to East Germany. And Japan (which has been financing the US's debts and has been acting as "the world's lender of last resort") is in trouble. The Japanese savings rate has dropped from $90 billion a year to $55 billion, and its big institutions have been selling off some of their US Treasury bonds.

In the face of all this, global interest rates have been rising, but so far the international liquidity squeeze has not really impacted on the US economy. But it's early in the game, and the trouble may yet come. Strangely, and this is a Russell observation, -- markets today move more rapidly than ever before, but world economies seem to move more slowly than before. Markets move quickly because of instant electronic communications. Economies move slowly because governments and central banks have learned how to lean against the wind (but note, I said they've learned to "lean against the wind," not reverse the direction of the wind).

* *

The dispute between Quebec and the Canadian government continues. A proposed constitutional amendment known as the Meech Lake accord, if approved, would recognize Quebec as a "distinct society" within Canada. If the accord isn't ratified by June 23, Quebec politicians threaten to seek independence from Canada. If that happens, it could possibly upset the Canadian dollar, and this is the "fly in the ointment" in buying currently high-yielding Canadian T-bills. Of late, the Canadian dollar has acted poorly, and thus I must rescind my advice about buying Canadian T-bills. Regardless of their fat yield, the weak C. dollar now renders them unattractive for Americans.

* *

Margin debt throughout stock market history has had a strong tendency to move in harmony with the primary trend of the market. In a bull market the speculator, using his margin account, tends to assume progressively larger margin positions. A bear market kills the speculator, and as a bear market progresses, margin accounts steadily decline. The margin accounts on the NYSE have now declined for five months running. Normally (but these may not be normal times) this would be confirmation that a bear market is in progress (and if you watch the advance-decline ratio you would agree).

* *

There's an insert with this Letter telling you about the big San Francisco seminar. Like all other Githler seminars, this one is calculated to be a winner. I'll be there (speaking), and you can bet that I'll be chomping down at least three delicious dinners in SF's huge Chinatown (I *love* Chinese food).

* *

Japan's major car companies are not only rolling over Detroit, they're rolling over lesser Japanese car companies. In 1989 Suzuki's sales to the US dropped 47% from the previous year, Subaru dropped 12.7%, Mazdas sunk 2.1%. Talk now is of mergers with some of the Japanese biggies taking over smaller companies.

* *

Newspapers are in a profit squeeze due to a drastic drop in advertising income. But that hasn't hurt the *LA Times'* circulation. The *LA Times* is now the largest metro in the nation with 1,210,077 million in daily circulation, and now passing the *New York Daily News* which has shrunk to 1,180,139 in daily circulation. But the Sunday circulation champ is the Sunday *New York Times* with a circulation of 1,706,013. Meanwhile, *The National*, the all-sport daily is due to expand. In July, *The National* will be distributed in San Diego.

* *

Roughly 83% of the US Post Office's costs go to salaries, and the average salary (including pensions and extras) runs to $43,000 a year. These are the highest paid semi-skilled workers in the US. But this ridiculous set-up will be facing reality soon, and the reality is that the PO is pricing itself out of the market. The big upcoming competition will be FAX, which is not only light-years faster, but will soon be cheaper for local mail. Furthermore, the newspapers are beginning to note this!

You can fax letter locally for less than price of U.S. mail

Once again, the communications era is about to touch the common man.

A phone company executive has concluded that on some occasions it soon will be cheaper to send a letter by fax than to mail it.

And fax machines for under $500 are available for use in the home, bringing the cost down to level of a good VCR.

Said Tom McNaghten of Pacific Bell:

Faxing a letter to any point in your local calling area is free if you pay the phone company the $8.25 a month charge for phone service.

But, if the U.S. Postal Service increases the cost of a first class letter to 30 cents, said McNaghten

* *

South Korea's high-flying stock market has come down to earth. From its April '89 high of 1007, the S. Korean market has been hit hard. A few weeks ago the market crashed, dropping to a low of 688 (down 32% from its high). Furious Korean investors (used to a doubling market every year) stormed brokerage offices and smashed quote machines and furniture. S. Korea has been having vicious strikes plus 12% inflation plus a growing trade deficit.

* *

The easing of tensions between Russia and the West has left the Pentagon in a tizzy. The dissolution of the "big war" scenario has left military professionals in a stance midway between confusion and depression. In the military and at the Pentagon, many experts have spent their lives (and have based their promotions) on expertise in analyzing the relative strengths of the Soviets vs. the US. Now those efforts have gone up in smoke. Said one Pentagon official, "It's going to be very difficult for this building to make the transition. If you give up the Soviet threat, you're looking into an abyss."

* *

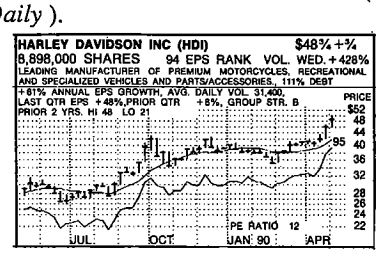
Heard this story (it's a true one) about an American who was treating a Russian friend to some American fast food. "You'll love this," the American told the Russian, "We call it a hot dog." The Russian eyed the treat a bit tentatively and replied, "I don't mean to be disrespectful, but would it be perhaps possible that I could have another part of the dog."

* *

Tobacco Facts: Nobody hates smoking like an ex-smoker, and I'm one (I quit in 1970). By the way, they say that if you quit smoking and there are no repercussions ten years after quitting, it's almost as if you never smoked. Nicotine is credited with killing 50 times as many people annually as drugs. Among adult black Americans, a whopping 40% smoke. Tobacco companies spend $2.5 billion a year in advertising their product. California claims that smoking costs 30,000 deaths in the state annually and some $7 billion in health care costs and lost productivity.

* *

When I park my Harley here in La Jolla people often walk up, look it over, and ask questions about it. I usually answer that, "It's one of the few things made in America that works." At any rate, Harley's stock works too, and it recently hit a record high. Reason: Harley's sales are outpacing delivery. Also, there is talk of a takeover. Here's what the stock looks like (chart courtesy of *Investor's Daily*).



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Is there a Jew alive who can feel totally happy about the unification of Germany? I'm a Jew, and I put my life on the line in the last war against Germany. Yet I'm in favor of German unification. Why? I guess because I'm basically an optimist. The *New York Times* (May 6) publishes an article by Arthur Miller, the playwright, entitled "Uneasy About the Germans." Miller notes that, "No German alive has ever fought for Democracy". He continues, "What do I care if a Nazi says he's sorry? I want to know what the Constitution and educational systems of Germany are doing to defend democracy under possibly the most difficult future circumstances. That is important to me and my children. . . .The world has a right -- its World War II dead have earned it the right -- to reproach and criticize and make demands of Germans if and when they seem to revert to bad habits. For a long time to come, the Germans are going to have to face the legacy of their last attempt to dominate other nations."

Russell comment: Amen. I don't want my son Ryan to have to fight the Germans in the year 2010. My father fought the Germans in WWI. I fought them in WWII. Enough, damn it.

* *

Don't miss the interview with Paul Tudor Jones in the May 7 issue of *Barron's*. Jones is, in my opinion, one of the smartest and best informed people in this business, bar none. Jones' observations in the interview are brilliant, and thought-provoking. By the way, Jones is one of the biggest and most successful futures traders in the business. He's a market man through and through (when I read opinions, I only trust them when they come from market men, as opposed to say professors, theorists or politicians).

* *

That's Hollywood: Ted Field, film producer ("Three Men and a Baby") and heir to the Marshall Field fortune, has put his 16-acre Westside estate (LA) up for sale. Price: $55 million. It's the highest price ever asked for a private home. Field also listed his 15,000 square feet home in Aspen for sale. Price $29 million. But Field is buying his third wife (he just divorced her and they're still friends) a 23,000 square foot home in Beverly Hills, priced at $14 million.

* *

From our "Gee, I Never Would Have Guessed It" Department (a clip from the*WSJ*, May 10).

Inflation May Be Worse Than Data Show

Property Taxes, Health Costs, Other Hard-to-Measure Forces Cited

By Pamela Sebastian
Staff Reporter of The Wall Street Journal

NEW YORK—While inflation gnaws at consumers and policy makers, some economists say the actual bite on many household

are starting to pass through to the index. "If April is like March, [the tax boost lag] will probably catch up," he says.

Quirks in the CPI could be significant

tended to reflect specific inflation felt by special demographic groups such as the elderly, some analysts believe that today's demographics herd more people into these

* *

A subscriber writes, "Your comment on the exponential population growth of the world with its disastrous results, if it continues, is frightening. Don't you realize that it is people like you, with five children, that are the cause of the problem?" Russell response: Yeah, I do, and I apologize. But (1) I triggered my kids before I realized what a problem the exploding population was becoming. (2) At least I supported my kids, and with my last two, I still do.

* *

Today I received a personal letter (it was very constructive and polite) from Mr. Anthony Frank, the US Postmaster General. Mr. Frank said his broker sent him a copy of my April 4 Letter. Mr. Frank writes that he feels the cost of mailing should go up less than the inflation rate, and he admits that "it is not the case with this rate filing." I realize the Postmaster has many problems, and that the solutions are very difficult. And I'm afraid that in the end free enterprise is going to solve the problem. I'm referring to FAX. What I mean is that FAX will solve the problem for those of us who want rapid communications; it will not solve the problem for the Post Office.

REAL ESTATE: One of the keys to the economic picture is the price level of real estate. This is where the wealth of the most Americans lies. In a recent issue, *US News & World Report* lists the 25 hottest real estate markets in the nation, along with the appreciation rates of each (i.e., 1990 price vs. 1989 price). Hottest areas are (1) W. Palm Beach, up 24.1%, (2) Akron, up 22%, (3) Greenville, S.C., up 20.7%, (4) Mobile, up 19.9%, (5) Sacramento, up 19.3%, (6) Honolulu, up 18.1%, (7) El Paso, up 17.6%, (8) Chicago, up 16.4%, (9) Houston, up 16.3%, and (10) LA, up 15.7%. Of the top ten, the least affordable areas according to the magazine are Honolulu, LA and Sacramento. The rest of the areas are attractive if you don't mind the climate.

My own feeling is that the key to the global economy is debt and real estate. If these two can somehow be handled, juggled or held off, all may be well, at least for a while. But the debt build-up (particularly in the US) and the (often absurd) real estate prices are the key to the inflation/deflation equation. The question, of course, is what will happen to the mountains of debt now created and what will happen to the (in many cases) overpriced real estate market?

We are moving nearer and nearer to the time when we must either inflate big or we will deflate big. Actually, you don't have to go far to see indications of each today. Of course, the choice the politicians invariably opt for is inflation. But today it's a question of whether the market will stand for persistent inflation.

I think about the problem a great deal, and this is the way I see it -- the markets won't stand for steadily rising inflation, and the markets won't hold up under steadily increasing deflation. The ultimate outcome -- I just don't know, but this grim inflation/deflation struggle is one of the things that is giving us erratic markets today.

If there is deflation, no one knows where it will start, but it will probably start either in Japan or the US. Japan's total real estate is valued at $13.9 trillion vs. $4 trillion for the US. However, the US is 25 times the size of Japan, and that means that land prices per acre in Japan are 25 times as high as in the US. The average yield on Japanese land is 1.5%, which was all right as long as Japanese bonds were yielding 4% or less. But with their bonds now pushing near 7%, 1.5% on real estate is looking mighty thin (or to put it another way, Japanese real estate prices are looking awfully high).

In the end, as I've often said, all prices move towards value, and value in turn revolves around the return on the investment. Can Japanese and US real estate prices hold up with world interest rates as high as they are? We should know fairly soon.

GOLD: When gold advances against the dollar or any other currency it's a sign that that currency is weak (depreciating). It's also an indication of inflation. Consequently, rallying gold is the last thing the Fed and the US Treasury want to see. Rumor is that the US engineered the recent Saudi dumping of gold. And we know that the US recently asked the International Monetary Fund to sell gold. Let me put it this way -- the boys in charge of US finances will do anything in their power to keep the price of gold down. They never stop trying.

I.M.F. Is Asked To Sell Gold

WASHINGTON, March 1 (AP) — The United States asked the International Mone-

ZURICH, Switzerland (Reuter) — The Soviet Union, the world's second-biggest gold producer, has stepped up gold sales in a possible bid to raise hard cash to buy foreign grains and pay off debts owed by Soviet companies to overseas suppliers, traders said yesterday.

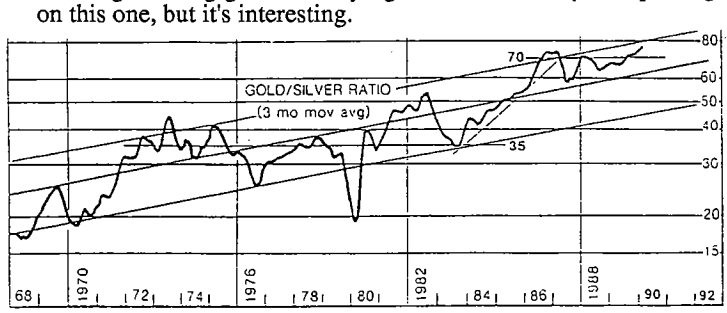
But traders said Moscow could be selling gold this time to bail out Soviet companies that have started to fall behind in overseas payments.

Japanese traders said yesterday that Soviet enterprises have delayed payments worth hundreds of millions of dollars.

The near-bankrupt Soviets have had trouble paying their bills, and to raise money they have been selling gold. In fact, Soviet stalling on bill payments has caused many suppliers to halt delivery of goods. Up to this point the Soviets have been selling gold to raise money, but this can't continue (Soviet purchases far outweigh their gold production). What the Soviets will have to do is stop selling their gold and instead, use their gold to make the ruble convertible. One of these days (soon I would guess) this idea will dawn on the Russians, and then they will have every incentive to move the price of gold up -- instead of selling and putting pressure on the metal.

In the meantime, the burning question is whether gold is basing in the 360-370 zone. I think there's a good possibility that it is. The first hint of strength would be the June gold contract rallying above 375.

Of interest here is the ratio of silver to gold. Historically, the silver/gold ratio has hovered around the 15 area, which means that an ounce of gold would have purchased 15 ounces of silver. This chart (from my friend, Ian McAvity's *Deliberations*) shows what has happened to the ratio since 1968. Currently, in terms of gold, they're giving away silver. For this reason, many services are advising shorting gold and buying silver. Personally, I'm passing on this one, but it's interesting.



Has weak gold altered the case for accumulating gold on a fixed-dollar monthly purchase basis? My answer is no. The following paragraph from the excellent *Lynch International Investment Survey* (301 Main St., STE 206, Port Washington, NY 11050) is well worth pondering: "Poland, Czechoslovakia, Hungary, Romania and Bulgaria are all in real need of Western goods and materials -- but the hard currency payments must come from Western loans -- IMF, World Bank, industrial nations and commercial banks. Their needs could well dwarf the now defaulted debts of the Third World. In our opinion, Brazil, Mexico and Argentina look like good credit risks when compared with the current financial position of the former Communist satellites. The West will make the loans -- and will be stung just as they have been in the past. The worst part is that to finance the East Bloc's needs and demands, they will create more and more money out of thin air. We see worldwide inflation building rapidly -- and the US will not escape it. An investment hedge in gold becomes all the more necessary."

Russell comment: Martin Lefkowitz, economist with the National Chamber of Commerce Foundation, annually updates an inflation index going back to 1965. His index shows that today you would need $4.13 to buy what you could have purchased for $1 in 1965. With the federal debt astronomically higher today and with US and world debts rising rapidly, how many dollars do you think you'll need in say 1999 to purchase $1 worth of today's goods?

LATE NOTES: Did last Friday's explosive upside action render everything I've written in this Letter obsolete? I don't think so. I buy stocks only at advantageous LOW RISK areas. My work doesn't show me that we've seen such an area. I'm patient, and I'll wait. If you have patience, the market always gives you what you want. But the market doesn't run on my time schedule or your time schedule. The market is a law unto itself.

As this is written the Dow is above its all time high, and it seems as if nothing will satisfy the gods of the market until the Dow actually closes over 2810.15, thereby establishing a new record high. It's a high that will be advertised around the world. Then what? We'll see -- but it's important to remember Russell's Law, "Above all, don't lose money." One way of not losing money is to buy stocks at great buy areas.

There's plenty of institutional money on the sidelines, and a new Dow high will undoubtedly send many of these managers scrambling to get more fully invested. There's a drama unfolding here, but the play may not develop exactly as predicted.

NEXT MAILING: May 30